

Message Text

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ACTION AID-59

INFO OCT-01 NEA-10 ISO-00 L-03 AGRE-00 COME-00 TRSE-00
EB-08 OMB-01 SP-02 CIAE-00 INR-10 NSAE-00 IO-13
/107 W

-----004487 151226Z /47

R 140530Z SEP 78
FM AMEMBASSY COLOMBO
TO SECSTATE WASHDC 1338
INFO AMEMBASSY NEW DELHI
AMEMBASSY ROME

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DEPT PASS USDA FOR PL 480 TITLE I COORDINATOR NORTON;

NEW DELHI FOR AGATT, ROME FOR FODAG

E.O. 11652: N/A
TAGS: EAGR, EAID, CE
SUBJECT: CENTRAL BANK STUDY ON DISINCENTIVE EFFECTS OF FOOD AID

REF STATE 165684 (NOTAL)

1. THE EMBASSY HAS RECEIVED THE CENTRAL BANK'S STUDY ENTITLED
"DISINCENTIVE EFFECTS OF FOOD AID ON FOOD PRODUCTION IN SRI
LANKA" (SIX COPIES BEING POUCHED TO DEPARTMENT) WHICH STATES
"THE RESULTS (OF THE STUDY) DO NOT INDICATE A DIRECT
DISINCENTIVE EFFECT OF FOOD AID ON DOMESTIC PRODUCTION...".
THIS FINDING IS BASED ON A MULTIPLE REGRESSION ANALYSIS OF
THE IMPACT OF FOOD AID (WHEAT, WHEAT FLOUR, AND RICE) IMPORTS
FROM 1961 TO 1977 ON THE LOCAL PRODUCTION OF RICE, OTHER GRAINS
(MAIZE, GREEN GRAM, AND KURAKKAN), AND YAMS (MANIOC AND
SWEET POTATOES).

2. ALTHOUGH FOOD AID, PER SE, WAS FOUND TO HAVE NO DISINCENTIVE
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EFFECT, THE STUDY DID FIND THAT TOTAL IMPORTS OF RICE AND FLOUR
BOTH COMMERCIAL AND AID) HAD A DEPRESSING EFFECT ON THE
DOMESTIC FOOD PRICES AND THEREBY A MARGINAL DISCOURAGING
EFFECT ON PRODUCTION." THE HIGH LEVEL OF IMPORTS
PARTICULARLY FLOUR, WAS NOT DUE TO FOOD AID, THE
REPORT STATES,BUT RATHER TO THE GOVERNMENT'S
POLICY OF SUBSIDIZING FLOUR PRICES, AND TO "CONSIDERABLE

PRESSURE FROM THE DONOR COUNTRIES ON SRI LANKA TO IMPORT A CERTAIN MINIMUM QUANTITY OF FOOD SUPPLIED (ESPECIALLY FLOUR) FROM THE TRADITIONAL SUPPLIERS" LOW FLOUR PRICES WERE FOUND TO BE A DEFINITE DISINCENTIVE TO DOMESTIC FOOD PRODUCTION.

3. WHILE ACKNOWLEDGING THAT CARE SHOULD BE TAKEN "NOT TO OVERSUPPLY THE MARKET WITH EXCESSIVE FOOD IMPORTS, AND THAT THE FOOD IMPORTED THROUGH AID OR OTHERWISE SHOULD BE REALISTICALLY PRICED," THE STUDY ARGUES THAT FOOD AID SHOULD BE INCREASED TO PROMOTE DEVELOPMENT THROUGH GREATER RESOURCE FLOWS. THE STUDY ALSO CLAIMS THAT REDUCED USUAL MARKETING REQUIREMENTS (UMR'S) IMPOSED BY FOOD AID DONORS "WOULD HELP TO PREVENT EXCESSIVE IMPORTS OF FOOD, PARTICULARLY FLOUR..."

4.COMMENT: THE CENTRAL BANK'S REPORT IS NOT WELL DONE. IT IS POORLY WRITTEN AND SOME OF THE REASONING IS OBSCURE. THE FINDING THAT BOTH THE IMPORTATION AND PRODUCTION OF FOOD GRAINS IS GREATLY INFLUENCED BY DOMESTIC PRICES IS LESS THAN PROFOUND. THE CONCLUSION THAT FOOD AID IS NOT A DISINCENTIVE TO PRODUCTION AND THE PLEA FOR GREATER AMOUNTS OF FOOD AID ON EASIER TERMS ARE OBVIOUSLY SELF-SERVING. NEVERTHELESS, DESPITE THE INADEQUACIES OF THE STUDY, THE EMBASSY AGREES WITH THE BASIC CONCLUSION THAT FOOD AID IS NOT A DISINCENTIVE.
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5. IMPLICIT IN THE STUDY IS THE VALID POINT THAT FLOUR PRICES, AND TO A LESSER EXTENT RICE PRICES, HAVE USUALLY BEEN FIXED BY THE GOVERNMENT FOR SHORT-TERM POLITICAL REASONS INDEPENDENT OF LONGER-TERM ECONOMIC CONSIDERATIONS. ONCE A PRICE FOR FLOUR IS SET, THE RESULTING DEMAND MUST BE MET. TO THE EXTENT FOOD AID IS NOT AVAILABLE, THE DEMAND IS MET THROUGH COMMERCIAL IMPORTS. THIS WAS PARTICULARLY THE CASE DURING THE PREVIOUS GOVERNMENT WHICH GAVE FIRST PRIORITY IN FOREIGN EXCHANGE ALLOCATIONS TO FOOD IMPORTS, INCLUDING LARGE AMOUNTS OF COMMERCIAL FLOUR AND RICE. AFTER PAYING FOR IMPORTS OF FOOD AND PETROLEUM, LITTLE FOREIGN EXCHANGE WAS LEFT FOR OTHER IMPORTS, AND THE AGRICULTURAL AND INDUSTRIAL SECTORS STAGNATED FOR LACK OF INPUTS. THIS DID NOT KEEP THE PREVIOUS GOVERNMENT FROM LOWERING THE PRICE OF FLOUR FROM RS.1.10 TO RS 0.80 PER POUND IN AN EFFORT TO WIN VOTES. NOR DID IT STOP THE PRESENT GSL FROM DROPPING THE PRICE TO RS.0.60 PER POUND JUST AFTER THE ELECTION TO SHOW IMMEDIATE PROGRESS ON ITS ELECTORAL PROMISE TO REDUCE THE COST OF LIVING.

6. IN MAKING THIS DECISION, THE PRESENT GSL'S POLICY

MAKERS OBVIOUSLY GAVE NO THOUGHT TO WHAT IMPACT THE
COMING DEVALUATION OF THE RUPEE, WHICH BEGAN SLOWLY
ONLY SIXTEEN DAYS AFTER THE FLOUR PRICE CUT AND
CULMINATED IN THE MASSIVE DEVALUATION ON NOVEMBER 15, WOULD
HAVE ON THE SUBSIDY COST. NOR APPARENTLY, WAS ANY
CONSIDERATION GIVEN TO WHAT EFFECT SUCH A LOW FLOUR PRICE
WOULD HAVE ON THE DEMAND FOR RICE AND OTHER DOMESTIC
GRAINS. FORTUNATELY, THE NEW GSL QUICKLY REALIZED ITS
MISTAKE AND HAS INCREASED THE PRICE OF FLOUR THREE TIMES
IN THE PAST YEAR. WHILE THERE IS STILL A SIZEABLE SUBSIDY,
IT IS APPARENT THE GSL PLANS TO ELIMINATE THE SUBSIDY AS
QUICKLY AS THE POLITICAL CLIMATE WILL PERMIT.

7. IN PRIVATE CONVERSATIONS, CENTRAL BANK OFFICIALS CLAIM,
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AND WE AGREE, THAT THE AVAILABILITY OF FOOD AID WAS NOT AN
IMPORTANT FACTOR IN THE TWO GOVERNMENTS' DECISIONS TO
LOWER AND THEN RAISE FLOUR PRICES WHILE FOOD AID IS IMPORTANT
FOR BALANCE OF PAYMENTS' REASONS, THIS HAS BEEN OF ONLY
PERIPHERAL INTEREST TO SENIOR POLICY MAKERS WHO TEND TO
OPERATE ON THE BASIS OF POLITICAL INSTINCT RATHER THAN
ECONOMIC REASONING.
WRIGGINS

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Message Attributes

Automatic Decaptioning: X
Capture Date: 01 jan 1994
Channel Indicators: n/a
Current Classification: UNCLASSIFIED
Concepts: CENTRAL BANK, STUDIES, FOOD ASSISTANCE
Control Number: n/a
Copy: SINGLE
Draft Date: 14 sep 1978
Decaption Date: 01 jan 1960
Decaption Note:
Disposition Action: RELEASED
Disposition Approved on Date:
Disposition Case Number: n/a
Disposition Comment: 25 YEAR REVIEW
Disposition Date: 20 Mar 2014
Disposition Event:
Disposition History: n/a
Disposition Reason:
Disposition Remarks:
Document Number: 1978COLOMB04145
Document Source: CORE
Document Unique ID: 00
Drafter: n/a
Enclosure: n/a
Executive Order: N/A
Errors: N/A
Expiration:
Film Number: D780375-1106
Format: TEL
From: COLOMBO
Handling Restrictions: n/a
Image Path:
ISecure: 1
Legacy Key: link1978/newtext/t19780968/aaaacdzk.tel
Line Count: 144
Litigation Code IDs:
Litigation Codes:
Litigation History:
Locator: TEXT ON-LINE, ON MICROFILM
Message ID: 206db350-c288-dd11-92da-001cc4696bcc
Office: ACTION AID
Original Classification: LIMITED OFFICIAL USE
Original Handling Restrictions: n/a
Original Previous Classification: n/a
Original Previous Handling Restrictions: n/a
Page Count: 3
Previous Channel Indicators: n/a
Previous Classification: LIMITED OFFICIAL USE
Previous Handling Restrictions: n/a
Reference: 78 STATE 165684
Retention: 0
Review Action: RELEASED, APPROVED
Review Content Flags:
Review Date: 05 may 2005
Review Event:
Review Exemptions: n/a
Review Media Identifier:
Review Release Date: N/A
Review Release Event: n/a
Review Transfer Date:
Review Withdrawn Fields: n/a
SAS ID: 1438083
Secure: OPEN
Status: NATIVE
Subject: CENTRAL BANK STUDY ON DISINCENTIVE EFFECTS OF FOOD AID
TAGS: EAGR, EAID, CE
To: STATE
Type: TE
vdkgvwkey: odhc://SAS/SAS.dbo.SAS_Docs/206db350-c288-dd11-92da-001cc4696bcc
Review Markings:
Sheryl P. Walter
Declassified/Released
US Department of State
EO Systematic Review
20 Mar 2014
Markings: Sheryl P. Walter Declassified/Released US Department of State EO Systematic Review 20 Mar 2014